



First, most will try to broaden the market by offering to pay a lender to drop a buyer's rate a percentage point or two for the first two or three years. If builders do it, then there is absolutely no reason why individual sellers can't do it too.

Not only does the technique stretch the market further than lowering prices, **it has a greater impact on the buyer's monthly mortgage payment**, even in today's low-interest-rate environment. And for most buyers, the bottom line is not so much the actual price of the house but how much they'll have to pay each month.

- Buy-downs work like this: For a fee, usually paid by the seller, a lender agrees to lower the buyer's mortgage rate in stair-step fashion for one to three years.
- A typical buy-down, known as a "2-1" buy-down, calls for a rate that's 2 percentage points below market for the first year. In the loan's second year, the rate rises to 1 percentage point below the rate at the time the loan was made. And after two years, it goes up once again, this time to the original rate, where it remains for the life of the mortgage.
- Other popular versions include a 3-2-1 buy-down in which the rate is 3 points below market the first year, 2 points during the second year and 1 point in the third, and a condensed buy-down in which the rate rises every six months instead of every 12.

To see how the concept works, and why it's almost always a better bet than lowering your price, let's assume a \$165,000 selling price. If a buyer puts up \$16,500 in cash as a down payment, he or she would have to finance \$150,000. And at 6 percent, the payment for principal and interest would be \$899 a month.

However, if the seller agrees to pay the cost of a 2-1 buy-down, the buyer's monthly principal and interest payment at 4 percent for the first year would be \$716, a difference of \$183 a month or \$2,196 a year. The payment would rise to \$805 in the second year, but that's still a savings of \$94 a month or \$1,128 for the entire year.

The payment would rise to \$899 in the third year. But over the 24 months, the buyer's total savings is \$3,324.

That's also what it would cost the seller to buy-down the buyer's interest rate.

- Of course, as an alternative, you could cut your price by the same amount. But since most conventional loans are approved based on the borrower's first-year interest rate, your universe of potential buyers would not be nearly as great.

Because most loans these days are based on the borrower's credit score instead of debt-to-income ratio, it's difficult to say with any certainty exactly how many more potential buyers would qualify to purchase your house at a lower rate.

But it's easy to see how much more meaningful it is to lower the rate rather than the price by returning to the above example:

- If you cut the price by \$3,324, which is the cost of the buy-down, the monthly payment at 6 percent would be \$879. That's only a \$20 difference versus \$183 in savings resulting from the buy-down.

With the buy-down, the eventual buyer in the example above only has to earn enough to afford a \$716 a month house payment rather than \$879.

The differences are even more striking on higher priced houses or when mortgages are more expensive. For example:

- On a \$250,000 mortgage at 6 percent, the monthly payment is \$1,499. But at 4 percent, it's just \$1,194, a difference of \$305. At 5 percent, the second year payment would be \$1,342. But the total two-year savings would be \$5,544.

If the seller in this case "spent" that amount to lower the selling price and thus the buyer's mortgage to \$244,456, the payment at 6 percent would be \$1,465, or just \$33 a month less than if the seller did absolutely nothing. There's a big difference between \$305 a month and \$33.